

Message Text

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ACTION ARA-14

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SUBJECT: ECONOMIC ALERT REPORT- VENEZUELA

REF: STATE 180067

MAJOR ECONOMIC PROBLEMS

1. VASTLY INCREASED OIL REVENUES SINCE 1973 HAVE ENABLED VENEZUELA TO FINANCE VERY AMBITIOUS DEVELOPMENT PLANS AND SOCIAL PROGRAMS WHILE PROVIDING VENEZUELANS WITH A HIGH STANDARD OF LIVING. THE SURGE IN PETROLEUM INCOME HAS ALSO BEEN RESPONSIBLE, DIRECTLY OR INDIRECTLY, FOR THE MOST IMPORTANT ECONOMIC PROBLEMS FACING VENEZUELA TODAY (SEE CARACAS 7339).

2. INFLATION- MANY OBSERVERS BELIEVE THE COUNTRY'S MOST SERIOUS ECONOMIC PROBLEM IS INFLATION, A SYMPTOM OF THE ECONOMY'S INABILITY TO SATISFY THE LARGE INCREASE IN DEMAND SINCE 1973 FOR PRACTICALLY EVERY TYPE OF GOOD AND SERVICE. THE MONEY SUPPLY HAS EXPANDED BY 150 PERCENT IN THE 1973-76 PERIOD, AND AT AN ANNUAL RATE OF 31 PERCENT DURING THE FIRST HALF OF 1977. THE OFFICIAL PRICE INDEX IS UP ALMOST 30 PERCENT IN THREE YEARS

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BECAUSE THE INDEX UNDERSTATES PRICE MOVEMENTS, MOST OBSERVERS
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ESTIMATE THAT THE PRICE LEVEL MAY HAVE GONE UP AS MUCH AS 50 PERCENT DURING THE PERIOD. GOVERNMENT EFFORTS TO ESTABLISH PRICE CONTROLS AND LIMIT MONEY SUPPLY GROWTH HAVE BEEN ONLY PARTIALLY SUCCESSFUL (CARACAS 6891). PRODUCTION IN KEY SECTORS SUCH AS AGRICULTURE HAS NOT KEPT UP WITH DEMAND (A-56, MAY 6, 1977).

3. BALANCE OF PAYMENTS- VENEZUELA HAS RELIED INCREASINGLY ON IMPORTS FOR ESSENTIAL CAPITAL GOODS NECESSARY FOR ITS DEVELOPMENT PLAN AND TO MEET DEMAND CREATED BY THE NEW OIL WEALTH. IMPORTS ARE UP 140 PERCENT SINCE 1973 TO A 1976 LEVEL OF \$6.8 BILLION AND ARE ESTIMATED TO INCREASE ANOTHER 20-25 PERCENT IN 1977. FOR EXAMPLE, A SUBSTANTIAL PROPORTION OF FOODSTUFF REQUIREMENTS IS NOW IMPORTED. EXPORTS (MOSTLY OIL HAVE STABILIZED AT APPROXIMATELY THE \$9 BILLION MARK; INCREASES IN REVENUE OVER THE SHORT TERM CAN ONLY COME FROM INCREASES IN THE PRICE OF OIL SINCE THE INDUSTRY IS OPERATING AT CLOSE TO CAPACITY. AS A RESULT, VENEZUELA'S BALANCE OF PAYMENTS SITUATION SHIFTED FROM A SURPLUS OF OVER \$4 BILLION IN 1974 TO A DEFICIT OF \$286 MILLION IN 1976. (A-62, DATED MAY 13, 1977).

4. PUBLIC SECTOR- CENTRAL GOVERNMENT EXPENDITURES SOARED FROM \$3.5 BILLION IN 1973 TO \$10.3 BILLION IN 1976 (CARACAS A-28, FEBRUARY 28, 1977). STATE ENTERPRISES ARE MAKING HEAVY DEMANDS ON LIMITED REAL AND HUMAN RESOURCES WITH LITTLE IMMEDIATE RETURN ON THEIR INVESTMENT. THE GOVERNMENT URGENTLY NEEDS TO RESTRAIN CURRENT EXPENDITURE AND DEVELOP NEW SOURCES OF REVENUE TO FINANCE PRIORITY SOCIAL AND DEVELOPMENT PROGRAMS, BUT HAS BEEN UNSUCCESSFUL IN ITS EFFORTS TO DATE TO INCREASE THE RELATIVELY LOW TAX BURDEN ON INDIVIDUALS AND CORPORATIONS. OIL REVENUES, WHICH PROVIDE ABOUT 65 PERCENT OF THE GOVERNMENT'S CURRENT INCOME, OFFER LITTLE POTENTIAL FOR GROWTH, FOR BOTH POLITICAL AND ECONOMIC REASONS (CARACAS A-162, DECEMBER 14, 1976).
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OUTLOOK

5. THE 1978 PRESIDENTIAL CAMPAIGN IS WELL UNDER WAY, AND IT IS UNLIKELY THAT THE GOVERNMENT WILL IMPLEMENT POLITICALLY UNPALATABLE MEASURES (E.G., MEANINGFUL TAX REFORM, PRICE RATIONALIZATION) BEFORE DECEMBER OF 1978. SOME SORT OF LIMITATION ON IMPORTS CAN BE EXPECTED, ESPECIALLY FOR LUXURY GOODS; NEVERTHELESS, MODEST BALANCE OF PAYMENTS DEFICITS (UP TO \$500 MILLION) ARE LIKELY IN 1977 AND 1978, AS EXPENDITURES FOR ESSENTIAL INPUTS INTO PLAN V CONTINUE TO INCREASE. DEFICITS WOULD BE FINANCED BY DRAWDOWNS ON RESERVES OF FOREIGN EXCHANGE (\$9 BILLION) AND BY CONTINUED BORROWINGS ABROAD. UPWARD PRESSURE ON PRICES WILL CONTINUE AS GOVERNMENT SPENDING INCREASES OVERWHELM THE GOV'S EFFORTS TO COMBAT INFLATION THROUGH MONETARY MEASURES. BARRING UNFORSEEN DEVELOPMENTS, A SIGNIFICANT CHANGE IN THE VALUE OF THE BOLIVAR IS NOT LIKELY BEFORE DECEMBER OF 1978. VENEZUELA WILL CONTINUE TO SUPPORT FOR OPEC AND PETROLEUM PRICE INCREASES TO REDUCE THE SIZE OF PROSPECTIVE BUDGETARY AND BALANCE OF PAYMENTS DEFICITS.

CRITICAL POINTS.

6. MOST CRITICAL TO VENEZUELA'S CONTINUED ECONOMIC PROSPERITY AND WELL BEING ARE CONTINUED EARNINGS FROM THE SALE OF PETROLEUM ABROAD. SHOULD INCOME FROM THIS SOURCE BE THREATENED, IT COULD HAVE AN IMMEDIATE DESTABILIZING IMPACT ON VENEZUELA'S ECOMY. THE DEVELOPMENT PROGRAM WOULD BE CRIPPLED AND AMBITIOUS SOCIAL AND EDUCATIONAL PROJECTS CURTAILED OR ELIMINATED, VENEZUELA'S POLITICAL STABILITY WOULD BE JEOPARDIZED.

7. THE OTHER CTITICAL POINT IS THE PRESIDENTIAL ELECTION SECHEDULED FOR DECEMBER OF 1978. UNTIL THEN, THE GOV WILL TEND TO EVADE DIFFICULT DECISIONS. AFTER THE ELECTIONS, THE NEW ADMINISTRATION CAN BE EXPECTED TO TAKE A SERIES OF DIFFICULT DECISIONS INTENDED TO DEAL WITH EXTERNAL PAYMENTS AND BUDGETARY PROBLEMS, THE RELATIVE ROLES OF THE PUBLIC AND PRIVATE SECTOR IN THE ECONOMY, AND PRICE LIMITED OFFICIAL USE

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INFLATION.

8. FINALLY, WHILE NOT LIKELY TO REACH CRISIS PROPORTIONS DURING THE NEXT 12 MONTHS, THE PROBLEM OF SHORTAGES OF HUMAN RESOURCES IS A CRITICAL ONE AFFECTING EVERY ASPECT OF THE ECONOMY, PUBLIC AND PRIVATE SECTOR ALIKE. OVER THE LONG TERM, THIS PROBLEM WILL IMPACT ON PLAN V AT LEAST TO THE SAME DEGREE AS THE PROBLEMS OUTLINED IN PARAGRAPHS TWO, THREE, AND FOUR.
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